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March 21, 2003

HAND DELIVERED

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Re: ***Commonwealth of Virginia, ex.rel. State Corporation Commission***
In the matter of developing consensus recommendations on stranded costs
Case No. PUE-2003-00062

Gentlemen:

In accordance with the Commission's *Order Establishing Proceeding*, dated March 3, 2003, in the above matter ("Order"), I am submitting the Comments of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates ("Comments").

The Comments, at page 6, reference two documents as attachments. Both documents are "redacted" versions of testimony and exhibits. Neither contains information alleged to be confidential and proprietary. Pursuant to the Order, the Committees will await the development of procedures by the Commission's Office of General Counsel prior to any disclosure of "un-redacted" versions of the two documents.

Thank you for your assistance. Please contact me if you have any questions concerning this submittal.

Very truly yours,

Edward L. Petrini

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Ronald A. Gibson
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March 21, 2003
Page 2

cc: State Corporation Commission
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**COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION**

**COMMONWEALTH OF VIRGINIA, ex rel.
STATE CORPORATION COMMISSION
In the Matter of Developing
Recommendations on
Stranded Costs**

Case No. PUE-2003-00062

**COMMENTS OF
THE VIRGINIA COMMITTEE FOR FAIR UTILITY RATES AND THE
OLD DOMINION COMMITTEE FOR FAIR UTILITY RATES**

The Virginia Committee For Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (collectively, "the Committees"), by counsel, submit these comments in response to the questions posed by the Commission in its Order Establishing Proceeding, dated March 3, 2003. The Committees appreciate the opportunity to comment and look forward to participating in the work group established by that order.

Respectfully submitted,

**VIRGINIA COMMITTEE FOR
FAIR UTILITY RATES**

**OLD DOMINION COMMITTEE FOR
FAIR UTILITY RATES**

By Counsel

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March 21, 2003

RESPONSES TO QUESTIONS REGARDING JUST AND REASONABLE NET STRANDED COSTS

1. *Define "stranded costs." Include in the definition a detailed listing of each stranded cost component. Is this definition applicable to all electric utilities operating in Virginia? If not, to which utility or utilities does it apply and why?*

Stranded costs may be defined as booked, embedded generation-related costs that are not recovered or recoverable by an incumbent electric utility as a result of retail customer choice, as provided in Virginia's Electric Utility Restructuring Act ("Restructuring Act"). Stranded cost components include unrecovered and unrecoverable costs associated with each of the utility's generating units, purchased power contracts (including any non-utility generation, or "NUG," contracts), generation-related regulatory assets, and nuclear decommissioning costs (if applicable). A generating unit's stranded costs may not exceed its remaining net book value.

2. *Define "just and reasonable net stranded costs." Provide a detailed explanation of how and why it differs from "stranded costs." Is this definition applicable to all electric utilities operating in Virginia? If not, to which utility or utilities does it apply and why?*

"Just and reasonable net stranded costs" differ from "stranded costs." "Just and reasonable net stranded costs" include only "net" stranded costs that are "just and reasonable." "Net stranded costs" refer to the positive excess, if any, of generation-related stranded costs ("gross" stranded costs) over generation-related stranded "benefits." (Stranded "benefits" represent the inverse of stranded costs – the *excess* of market value over net booked, embedded costs.) Generation-related components of such costs include those identified in response to question 1 – *i.e.*, "just and reasonable net stranded costs" associated with the incumbent electric utility's generation units, purchased power contracts (including NUG contracts), generation-related regulatory assets, and nuclear decommissioning (if applicable). "Just and reasonable" net stranded costs include net stranded costs whose recovery would be permitted under traditional ratemaking principles designed to produce "just and reasonable," cost-based rates to utility customers. Thus, recovery of such costs in rates depends upon the fairness, or "justness," and "reasonableness" of allowing their recovery in rates, including the reasonableness and prudence of the utility's incurrence of such costs. Inquiry into the reasonableness of their recovery includes consideration of the extent to which the utility reasonably could avoid, or mitigate, or could have avoided or mitigated, such costs.

3. *Provide a methodology for calculating "just and reasonable net stranded costs." Be specific in providing the necessary steps, beginning with each component comprising gross stranded costs and each component offsetting this amount to reach a net amount.*

Calculation of "just and reasonable net stranded costs" includes a market assessment of the utility's generation and its purchased power contracts. The methodology should include the development of market prices for use in determining the market value for the utility's generating units and purchased power contracts. The market values are then compared with the remaining net book value of the generating units and generation-related regulatory assets, and the net present value ("NPV") of decommissioning costs. For purchased power contracts, comparison is made between the NPV of the stream of contractual costs and the NPV of the contracts at their market value.

A "market-based" determination of the market value of generation assets and obligations utilizes prices resulting from their sale, or the sale of related securities, in arm's-length transactions. This is distinguishable from "administrative approaches," which rely instead upon computer models to produce long-term projections of market prices over the useful lives of the utility's assets and the duration of such agreements.

An auction of entitlements to regulated generation capacity into the wholesale market, such as the capacity auctions required in Texas as part of that State's restructuring law, is one market-based methodology for determining market value. If asset ownership is transferred to a separate entity that then issues stock that is traded on a national exchange, moreover, the stock price may help determine market value of the underlying asset. The stock must be on the market for a sufficient period to establish a fair market value. If the asset is encumbered or if the transfer of the asset is not accomplished in a manner that maximizes its stock price, then appropriate adjustments are required to determine market value. Thus, an encumbrance that reduces the market value of the asset must be reflected in calculating stranded costs.

"Administrative" determinations may be more subject to manipulation than market-based approaches. As indicated above, they rely on computer models to produce long-term projections of market prices and market value. Administrative determinations must measure the full value of the utility's assets over their remaining useful lives. Value may be lost if the forward assessment of market prices is improperly time limited or fails to capture the true value of infrastructure unique to utility generating assets. (Such assets are valuable due to their limited number and strategic location near fuel and water supplies and the transmission grid.)

It is also important that models used in administrative determinations dispatch generating capacity that is economic to operate. A utility would not be prudent to operate generation when it would incur a loss in doing so.

If “administrative” approaches are used to project market values, careful attention must be paid to the underlying assumptions. Models that project the market value of such long-lived assets and obligations are especially sensitive to electricity price assumptions. In any case, as indicated above, stranded costs cannot exceed the remaining net book value of generating assets.

4. *Describe how stranded costs are recovered. Provide a methodology for calculating such recovery. Describe the recovery period.*

Under the Restructuring Act, an incumbent utility’s just and reasonable net stranded costs, to the extent that they exceed zero in value in total, are “recoverable,” provided that the utility “shall only recover” such costs “through either capped rates as provided in § 56-582 or wires charges as provided in § 56-583.” The Restructuring Act thus affords two means for the recovery of such costs – capped rates and wires charges.

A methodology for the recovery of such costs would calculate the utility’s annual revenues from capped rates and wires charges and the utility’s annual, jurisdictional revenue requirements through July 1, 2007. The excess of the sum of such annual revenues over the sum of such annual jurisdictional revenue requirements, and revenue from wires charges, would reflect the recovery of just and reasonable net stranded costs.

In calculating historic, annual revenue requirements, the Commission should rely upon traditional methods – *i.e.*, review of the utility’s annual information filings (“AIF’s”). In calculating projected annual revenue requirements, the Commission should rely upon traditional procedures for projecting the utility’s jurisdictional revenue requirements.

5. *Do the calculation and recovery methodologies described in responses to questions 3 and 4 produce (or are they likely to produce) over-recovery or under-recovery of just and reasonable net stranded costs? How should such over- or under-recovery be dealt with?*

The calculation and recovery methodologies described in the responses to questions 3 and 4 are likely to produce over-recoveries of just and reasonable net stranded costs. The Restructuring Act does not specify how an over-recovery or under-recovery should be “dealt with.”

One consequence of the over-recovery of such costs should be recommendations for the repeal of the Restructuring Act's provisions requiring the imposition of wires charges on customers that purchase power from alternative generation suppliers. As indicated above, the wires charges afford one of the two means of recovery of just and reasonable net stranded costs; however, if the incumbent utility's capped rates and wires charges are over-recovering such costs, any justification for the imposition of wires charges on such customers would be eliminated.

6. *Requested Actions paragraph 1 of the LTTF Resolution requests that the work group develop consensus recommendations "consistent with the provisions of the Act." Explain how that phrase guides or possibly constrains the actions of the work group. Identify each section of the Virginia Electric Utility Restructuring Act, §§ 56-576 to -596 of the Code of Virginia, pertinent to such guidance or constraint. Additionally, explain each such section's significance in the context of definitions offered in response to questions 1 and 2 as well as in the methodologies proffered for calculating and recovering just and reasonable net stranded costs in response to questions 3 and 4.*

The work group's recommendations must be consistent with the Act's requirement for consideration of -- "just and reasonable net stranded costs," as described above. See, Va. Code 56-584. Thus, for example, the group's recommendations should not fail to "net" the utility's stranded costs by ignoring generating assets that represent stranded "benefits."

The group's recommendations also must be "consistent with the provisions of the Act" in that they must rely upon the utility's capped rates and wires charges for determining revenues, and upon the utility's revenue requirements, as described above, in calculating the utility's over-recovery or under-recovery of just and reasonable net stranded costs.

7. *Provide copies of any study or studies undertaken to define and/or calculate stranded costs for any Virginia electric utility.*

In Case Nos. PUE9600036 and PUE960296,¹ a number of parties submitted testimony on the subject of Virginia Power's stranded costs and appropriate methodologies for calculating them. Virginia Power proposed a method for the calculation of such costs. Its method estimated stranded costs amounting to \$2.466 billion.² Other parties suggested that Virginia

¹ Application of Virginia Electric and Power Company 1995 Annual Informational Filing, Case No. PUE960036; Commonwealth of Virginia At the relation of the State corporation Commission, Ex Parte: Investigation of Electric Utility Industry Restructuring -- Virginia Electric and Power Company, Case No. PUE960296 ("PUE960296").

² Id., Direct Testimony of Robert E. Rigsby, Exhibit RER_(1), Transition Cost Report, at 12,

Power's estimate was far too high, and certain of them suggested that Virginia Power would experience net stranded benefits.³

Attached is a copy of the Direct Testimony and Exhibits of Jeffrey Pollock and Kathryn E. Iverson, filed on behalf of the Virginia Committee for Fair Utility Rates in that matter ("Ms. Iverson's testimony"). Ms. Iverson's testimony showed that, by correcting certain weaknesses in the analysis that produced Virginia Power's estimate, Virginia Power's estimated stranded net benefits soared as high as \$2.7 billion.⁴

Because other parties that submitted stranded cost studies in that matter are likely to participate in the instant matter, we assume that they will re-submit such studies in the instant matter in response to the Commission's order.

8. *Provide any additional comments on the issues raised by Requested Actions paragraphs 2 and 3 of the LTTF Resolution.*

Consideration of the overrecovery or underrecovery of "just and reasonable net stranded costs" is a complex, technical undertaking of obvious significance to all interested parties, including incumbent utilities, suppliers, customers, and the public. The Committees look forward to attempting to fashion a consensus, as described in the LTTF's resolution establishing the work group. In the absence of consensus on the issues identified by the LTTF, the work group should recommend that the Commission investigate the issues identified in the resolution for each incumbent utility by following the Commission's normal rules and

³ See, PUE960296, Direct Testimony of Craig R. Roach on behalf of the Virginia Independent Power Producers, Inc., at 86 ("... Virginia Power's transition cost estimates, although highly uncertain in any event are likely to be too high ..."); Direct Testimony of Bruce R. Oliver on behalf of the Apartment and Office Building Association of Metropolitan Washington, at 29 ("Although the work is still subject to refinement and revision, a preliminary set of calculations suggests that Virginia Power could have net negative transition costs [meaning net stranded benefits] when all elements of the company's generating plants and NUG contracts are considered."); Direct Testimony of William B. Marcus on behalf of the Southern Environmental Law Center, at 3 ("It [Virginia Power] appears to have grossly overstated its exposure to stranded generation costs (*i.e.*, by figures that could rise to the billions of dollars)."); and Direct Testimony of Don Scott Norwood on behalf of the Office of Attorney General, Division of Consumer Counsel, at 5 ("Virginia Power's stranded cost analysis is badly flawed... it appears likely that the Company will have stranded margins (negative stranded costs), even without the \$500 million of accelerated amortization it has proposed under the [Alternative Regulatory Plan].").

⁴ See, PUE960296, Ms. Iverson's testimony at 3, 25. Virginia Power later sought to withdraw its estimates, arguing, *inter alia*, that it had offered them only as "hypothetical or illustrative aggregate transition costs" in order "to establish that such costs present an issue of substantial magnitude that needs to be dealt with ... and to provide for Commission consideration of a means of calculating such costs and providing for their recovery." (See, Virginia Power's Motion to Simplify Proceeding, Case No. PUE960296, dated December 2, 1997, at 2). The Commission permitted the Company to withdraw its support for its estimates, but required, nonetheless, that the estimates remain in the case. PUE960296, Order on Motion to Simplify, February 13, 1998, at 5, 6.

procedures and that it make appropriate factual findings and recommendations for use by the LTTF.

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CERTIFICATE OF SERVICE

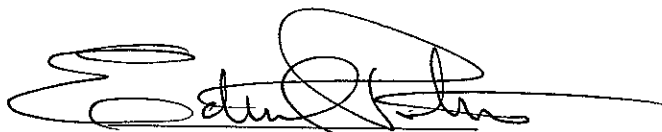
I hereby certify that a true copy of the foregoing was hand-delivered or mailed,
first-class postage prepaid, this 21st day of March, 2003, on each of the persons named
below.

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